

General Information Letter: With the exception of the subtraction allowed for College Savings Pool contributions in IITA Section 203(a)(2)(Y), Illinois treatment of IRC Section 529 plans follows the federal tax treatment.

February 7, 2002

Dear:

This is in response to your letter dated January 18, 2002 in which you request information regarding Illinois' taxation of Internal Revenue Code (IRC) Section 529 plans. The nature of your request and the information you have provided require that the Department respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's website at [www.revenue.state.il.us](http://www.revenue.state.il.us).

Your letter states as follows:

Mutual fund companies offer 529 college savings plans whose earnings are federally income tax free (See Attached). Is this also Illinois income tax free?

## **RULING**

### **Illinois taxation of Section 529 plans**

Section 16.5 of the State Treasurer Act, 15 ILCS 505/16.5, provides that the State Treasurer may establish and maintain a College Savings Pool in order to provide investment opportunities to persons seeking to finance the costs of higher education. The State Treasurer has titled the College Savings Pool program "Bright Start." Section 16.5 also states that the assets and income of a Bright Start program shall be exempt from all taxation by the State of Illinois. Section 15 of the Illinois Prepaid Tuition Act, 110 ILCS 979/15, creates the Illinois Prepaid Tuition program to better enable Illinois families to finance the costs of higher education. Section 55 of the Illinois Prepaid Tuition Act states that the assets and income of the Illinois Prepaid Tuition Trust Fund shall be exempt from all taxation by the State of Illinois.

Section 529(a) of the IRC states that a qualified state tuition program shall be exempt from federal income tax, except for the taxes imposed under IRC Section 511 (relating to the tax on unrelated business taxable income).

Under the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 *et seq.*), a taxpayer's Illinois base income is generally equal to its federal taxable income, adjusted by certain statutorily prescribed addition and subtraction modifications (See IITA §203). IITA Section 203(e)(1) defines "federal taxable income" for this purpose as the taxpayer's *"taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code."*

A Section 529 plan that is exempt from federal income tax does not have federal taxable income as defined under IITA section 203(e)(1). In addition, none of the statutorily prescribed addition modifications can apply. Accordingly, a Section 529 plan exempt from federal income tax does not have any Illinois base income and thus does not incur an Illinois income tax.

## **Illinois taxation of Section 529 plan participants and beneficiaries**

An individual's Illinois base income is equal to his federal adjusted gross income, modified by certain statutorily prescribed addition and subtraction amounts. As indicated above, Section 16.5 of the State Treasurer Act exempts the assets and income of a Bright Start program from all taxation by the State of Illinois. Section 55 of the Illinois Prepaid Tuition Act provides the same with respect to the Prepaid Tuition Trust Fund. In addition, Section 16.5 of the State Treasurer Act exempts from Illinois tax earnings accrued on investments in a Bright Start program upon distribution on behalf of a designated beneficiary to the extent used to pay qualified expenses. See Department Regulations §100.2470(g)(5). Likewise, Section 55 of the Illinois Prepaid Tuition Act exempts from tax the distribution of earnings accrued in the Prepaid Tuition Trust Fund to the extent used for educational purposes. See Department Regulations §100.2470(g)(4). Finally, IITA Section 203(a)(2)(Y) provides individuals a subtraction modification in the computation of base income for taxable years beginning on or after January 1, 2002 in an amount equal to all moneys contributed during the taxable year to a Bright Start program.

Based on the above, Illinois' taxation of Section 529 plan participants and beneficiaries is as follows.

With respect to contributions, the subtraction modification provided under IITA Section 203(a)(2)(Y) applies only to contributions made to a Bright Start program. Therefore, contributions made to a Bright Start program are not subject to Illinois income tax. Contributions made to other Section 529 plans are not deductible.

With respect to accrued earnings within a Section 529 plan, the exemptions provided under Section 16.5 of the State Treasurer Act and Section 55 of the Illinois Prepaid Tuition Act apply only with respect to the earnings of a Bright Start program or Illinois Prepaid Tuition Trust Fund, respectively. Therefore, earnings accrued in a Bright Start program or Illinois Prepaid Tuition Trust Fund are not subject to Illinois income tax. See Department Regulations §100.2470(g)(4-5). The IITA does not contain an addition modification that applies to earnings accrued within other Section 529 plans. Consequently, earnings accrued within other Section 529 plans are subject to Illinois income tax only to the extent included in the taxpayer's federal adjusted gross income.

With respect to distributions, the exemptions provided under Section 16.5 of the State Treasurer Act and Section 55 of the Illinois Prepaid Tuition Act apply only to the distribution of accrued earnings from a Bright Start program or Illinois Prepaid Tuition Trust Fund, respectively. Therefore, distributions from a Bright Start program or Illinois Prepaid Tuition Trust Fund are not subject to Illinois income tax to the extent used to pay qualified expenses. The IITA does not contain an addition modification that applies to distributions from other Section 529 plans. Accordingly, distributions from other Section 529 plans are subject to Illinois income tax only to the extent included in the taxpayer's federal adjusted gross income.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items one through eight of 86 Ill. Adm. Code 1200.110(b). If you have additional questions regarding this GIL, you may contact me at (217) 782-7055.

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Sincerely,

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